APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MILTON BARNES,	)	
	)	No. 96-16299
Petitioner-Appellant,	)	
	)	DC No. CV 96-957 MHP
vs.	)	
	)	**OPINION**
MARTIN LOGAN;	)	
KOREN LOGAN,	)	
Trustees for the Logan	)	
Inter Vivos Trust,	)	
	)	
Respondents-Appellees.	)	
	)	

Argued and Submitted July 15, 1997.

Decided August 20, 1997.

Frank Lewis, Begam, Lewis, Marks & Wolfe, Phoenix, AZ, for petitioner-appellant.

Craig M. Hughes, Zelle & Larson, San Francisco, CA, for respondents-appellees.

Appeal from the United States District Court for the Northern District of California; Marilyn H. Patel, District Judge, Presiding. D.C. No. CV-96-00957-MHP.

Before: HUG, Chief Judge, and FARRIS and TASHIMA, Circuit Judges.

TASHIMA, Circuit Judge:

This is an appeal from a judgment of the district court confirming an arbitration award under the Federal Arbitration Act, 9 U.S.C. §§ 9, 10. The district court had jurisdiction under 28 U.S.C. § 1332.[1] We have jurisdiction under 28 U.S.C. § 1291, and we affirm.

I. BACKGROUND

Respondents-appellees Martin and Koren Logan, husband and wife, and trustees of the Logan Revocable *Inter Vivos* Trust (collectively, Logan), were long-time customers of petitioner-appellant Milton Barnes (Barnes), a registered securities representative. Logan had followed Barnes from two prior brokerage houses to John G. Kinnard and Company, Inc. (Kinnard & Co.)

Logan, claiming that his account at Kinnard & Co. had been mismanaged and had declined in value from $464,000 to $269,000 in nine months, during which period Barnes had earned $123,000 in commissions, instituted an arbitration proceeding against Barnes, Kinnard & Co. and Scott R. Grady, the Kinnard & Co. Branch Manager in Phoenix. At issue in the arbitration were Logan's investment objectives, the extent of his "sophistication," how Barnes managed the account, and related issues (such

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[1] The Federal Arbitration Act does not independently confer jurisdiction. *Garrett v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*,, 7 F.3d 882 (9th Cir. 1993).

as asserted misrepresentations by Barnes and whether Barnes had engaged in churning the account).

Resolving the factual disputes in Logan's favor, a panel of arbitrators (arbitrators), appointed under the rules of the National Association of Securities Dealers (NASD), awarded Logan $261,561 in compensatory damages, plus $27,463 in pre-award interest. This award was made jointly and severally against Barnes, Kinnard & Co. and Grady. They also awarded Logan $500,000 in punitive damages against Kinnard & Co. and Grady, and $250,000 in punitive damages against Barnes. Barnes petitioned the district court to vacate the award against him, *i.e.*, the joint and several award of $261,561 (plus interest) in compensatory damages and the separate award against him of $250,000 in punitive damages.[2] The district court denied Barnes' petition to vacate the arbitration award and granted Logan's motion to confirm the award. Barnes timely appeals.

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[2] We have been informed that Kinnard & Co. and Grady have settled with Logan and that the amount of the settlement is less than Kinnard & Co. and Grady's total liability under the award. We therefore assume, for the purpose of deciding this appeal, that Barnes' contention regarding compensatory damages (which were awarded jointly against him, Kinnard & Co. and Grady) has not been rendered moot by the settlement. We leave the determination of this issue, *i.e.*, the extent to which, if at all, the Kinnard & Co. and Grady settlement discharged Barnes' joint and several liability to Logan for compensatory damages, to the district court in judgment enforcement proceedings or otherwise.

II. STANDARD OF REVIEW

Appellate courts review the confirmation or vacation of an arbitration award like "any other district court decision . . . accepting findings of fact that are not 'clearly erroneous' but deciding questions of law *de novo*." *First Options, Inc. v. Kaplan*, 514 U.S. 938, 947, 115 S. Ct. 1920, 1926, 131 L. Ed. 2d 985 (1995) (citation omitted); *Woods v. Saturn Distrib. Corp.*, 78 F.3d 424, 427 (9th Cir.), *cert. dismissed*, ___ U.S. ___, 117 S. Ct. 30, 135 L. Ed. 2d 1123 (1996). However, judicial review of an arbitrator's decision "is both limited and highly deferential." *Sheet Metal Workers' Int'l Ass'n v. Madison Indus., Inc.*, 84 F.3d 1186, 1190 (9th Cir. 1996). An award will not be set aside unless it manifests a complete disregard of the law. *Id.* Thus, an award must be confirmed if the arbitrators even arguably construed or applied the contract and acted within the scope of their authority. *United Food & Commercial Workers Int'l Union v. Foster Poultry Farms*, 74 F.3d 169, 173 (9th Cir. 1995). We may affirm the judgment of the district court on any ground fairly supported by the record. *Kruso v. International Tel. & Tel. Corp.*, 872 F.2d 1416, 1421 (9th Cir. 1989).

III. ANALYSIS

A. Punitive Damages

1. Choice of Law

The Customer Agreement between Logan and Kinnard & Co. provided in its paragraph 14, *Choice of Laws:*

> This agreement shall be deemed to have been made in the State of Minnesota and shall be construed, and

> the rights and liabilities of the parties determined, in accordance with the laws of the State of Minnesota.

Barnes contends that the arbitrators erred in awarding punitive damages because (1) the agreement is governed by Minnesota law, and (2) punitive damages are not permitted under Minnesota law where the only injury is economic.

In *Volt Info. Sciences, Inc. v. Board of Trustees of the Leland Stanford Jr. Univ.*, 489 U.S. 468, 109 S. Ct. 1248, 103 L. Ed. 2d 488 (1989), the Court held that the parties to an arbitration agreement could agree to which state's laws governed, even where the law chosen differed from the Federal Arbitration Act. *Id.* at 479, 109 S. Ct. at 1256. This principle was somewhat refined in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995). There the Client's Agreement contained an arbitration clause and a choice-of-law provision. The latter specified that the agreement was governed by New York law. *Id.* at 54-56, 115 S. Ct. at 1215. New York decisional law held that only judicial tribunals, and not arbitrators, were empowered to award punitive damages.[3] *Id.* The Court held that application of that caselaw was inconsistent with the Federal Arbitration Act and construed the choice-of-law provision, as follows:

> We think the best way to harmonize the choice-of-law provision with the arbitration provision is to read "the laws of the State of New York" to encompass substantive principles that

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[3] *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976).

> New York courts would apply, but not to include special rules limiting the authority of arbitrators. Thus, the choice-of-law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other.

Id. at 63-64, 115 S. Ct. at 1219.

Both sides claim to find support for their respective positions in *Mastrobuono*. Barnes contends that the substantive law of Minnesota governs the availability of punitive damages and, therefore, under *Masterbuono*, we must look to the Minnesota decisional law to determine if punitive damages were appropriately awarded. Logan contends that *Mastrobuono* stands for the proposition that because the parties chose to abide by the NASD rules of arbitration, and the NASD rules allow arbitrators to award punitive damages, punitive damages were appropriately awarded in this case. The Minnesota caselaw at issue, unlike the New York case involved in *Mastrobuono*, is part of the *substantive* law of Minnesota -- it is not a law that limits arbitrators or applies only to arbitration proceedings. It addresses the kinds of injuries for which punitive damages can be awarded.

In this respect, this case is similar to *Gateway Tech., Inc. v. MCI Telecomm. Corp.*, 64 F.3d 993 (5th Cir. 1995). *Gateway* involved an arbitration in which the arbitrator awarded $2 million in punitive damages. However, applying the holding of *Mastrobuono*, the court held that because punitive damages were available under applicable state law only for torts, and that case involved only a breach of contract, the arbitrator's award of punitive

damages was beyond his authority. *Id.* at 999 (also collecting cases), 1001. This case is like *Gateway* and unlike *Mastrobuono* in that the law on punitive damages, discussed below, is the substantive law of Minnesota.

The arbitrators expressly in this case awarded punitive damages "pursuant to Section 3294 of the California Civil Code and pursuant to *Mastrobuono.*" Thus, they acted beyond their authority and the applicable law in awarding punitive damages under California law, because the parties clearly had chosen Minnesota law as the governing law. However, as we demonstrate below, this error was harmless.

The Minnesota Supreme Court has held, at least in products liability cases, that punitive damages are recoverable only in cases of personal injury and not for economic injury.

> [T]he school district here only suffered property damage. The remedy of punitive damages concerns the "vital state interest of protecting persons against personal injury." We believe . . . that denying punitive damages where a plaintiff only suffers property damage reflects the greater importance society places on protecting people.

Independent Sch. Dist. No. 622 v. Keene Corp., 511 N.W.2d 728, 732 (Minn. 1994) (citation omitted) (*Keene*). *Keene* has been broadly interpreted as barring punitive damages in all cases not involving personal injury. *Soucek v. Banham*, 524 N.W.2d 478, 480 (Minn. Ct. App. 1994). However, *Soucek*, in turn, has been limited by what seems to be a more sensible interpretation of *Keene*. The latest

expression from a Minnesota appellate court limits *Keene* to products liability actions and permits the award of punitive damages for the deliberate disregard of rights, including for fraud. *Molenaar v. United Cattle Co.*, 553 N.W.2d 424, 428 (Minn. Ct. App. 1996).

Barnes contends that the arbitrators' decision should be vacated because they failed properly to apply Minnesota law. This contention is based on Barnes' reading of *Soucek* that, under *Keene*, punitive damages cannot be awarded in any case that does not involve personal injury. In his reply brief, he contends that *Molenaar*, which was not decided until after the arbitration was completed, represents a change in the law. On this basis, Barnes suggests that the arbitrators should have followed Minnesota law as it existed at the time of the arbitration.

On the other hand, Logan contends that Minnesota permitted punitive damages to be recovered for fraud well before *Molenaar*, citing *Jensen v. Peterson*, 264 N.W.2d 139, 144 (Minn. 1978). Logan is correct, at least in the sense that the Minnesota Supreme Court has continued to approve the award of punitive damages in cases not involving personal injury. *See, e.g., Phelps v. Commonwealth Land Title Ins. Co.*, 537 N.W.2d 271, 277 (Minn. 1995) (approving award of punitive damages, in addition to double damages, in age and disability discrimination in employment case).[4]

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[4] The arbitration in this case was conducted in October, 1995, and the award was rendered in January, 1996. *Phelps* was decided on Sept. 8, 1995, before the arbitration in this case took place.

Ordinarily, when we are faced with two conflicting decisions from a state's intermediate appellate courts, such as *Soucek* and *Molenaar*, "this Court must determine what decision the highest court [of the state] would reach if faced with the issue." *Capital Dev. Co. v. Port of Astoria,* 109 F.3d 516, 519 (9th Cir. 1997) (citation omitted). In this case, however, we need not engage in that analysis because the issue before us is not, precisely, what the Minnesota law of punitive damages is, but whether the arbitrators acted in manifest disregard of Minnesota law in awarding punitive damages.

In *Molenaar*, the Minnesota Court of Appeals, citing *Jensen* and *Phelps*, concluded that punitive damages were properly awardable for the intentional disregard of rights not involving personal injury. *Molenaar*, 553 N.W.2d at 427-28. If, under the current state of the law, a Minnesota intermediate appellate court can conclude that punitive damages are available even though no personal injury is involved, we cannot conclude that the arbitrators acted in manifest disregard of Minnesota law in awarding punitive damages.

Barnes has advanced no reason why it would be a manifest injustice to apply Minnesota law, as expounded by

Molenaar, to this appeal.[5] Because Minnesota law permits the award of punitive damages for fraud, the arbitrators' error in referencing California law in awarding punitive damages was harmless.

2. "Adams" Error

Barnes next contends that the award of punitive damages was in manifest disregard of the law, specifically of the requirement of *Adams v. Murakami*, 54 Cal. 3d 105, 284 Cal. Rptr. 318, 813 P.2d 1348 (1991), that evidence of a defendant's financial condition is a prerequisite to the award of punitive damages, *id.* at 325, 813 P.2d at 1355, and that the plaintiff bore the burden of establishing the defendant's financial condition. *Id.* at 330, 813 P.2d at 1360. *Adams*, however, is a requirement of California law, and we have concluded, above, that this arbitration is governed by Minnesota law. Under Minnesota law, there is no requirement, similar to *Adams*, that a claimant bear the burden of proving the wrongdoer's financial condition.

> Thus, evidence of a defendant's financial condition is an important consideration in determining whether a punitive damages award is excessive,

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[5] Although Barnes mounts a due process challenge to the award of punitive damages, discussed in Part III.A.3, below, it is not based on any asserted lack of fair notice that punitive damages were potentially awardable by the arbitrators. Therefore, we need not decide whether, in the circumstances of this case, there was such a lack of "fair notice," *see BMW of North America v. Gore*, ___ U.S. ___, ___, 116 S. Ct. 1589, 1598, 134 L. Ed. 2d 809 (1996), as would amount to "a manifest injustice."

> but it is not necessarily an essential element to prove entitlement to those damages.

Nugent v. Kerr, 543 N.W.2d 688, 691 (Minn. Ct. App. 1996).[6] Thus, not applying *Adams* was not in manifest disregard of Minnesota law.

For all of these reasons, the arbitrators' award of punitive damages was not in manifest disregard of the law.

3. Due Process

Barnes next makes something akin to a due process argument by contending that the award of punitive damages by arbitrators should be subject to some kind of "heightened scrutiny." However, as the district court recognized, we have "flatly rejected" this argument. In *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991), the appellant argued "that the punitive damage award here violates due process because the award is not subject to the procedural strictures of the courtroom." *Id.* at 1063. We held that a party cannot agree to arbitration,

> and then assert that an award made pursuant to that agreement . . . denies due process because it is not sufficiently reliable. Cunard had every opportunity to present evidence to argue the merits of its position, and to challenge the arbitrator's award in court. Having taken advantage of this process, into which it entered

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[6] The Minnesota rule represents the "majority view." *Kemezy v. Peters*, 79 F.3d 33 (7th Cir. 1996).

> voluntarily, Cunard cannot now argue
> that its due process was denied.

Id. at 1063-64. Thus, Barnes' due process challenge must fail. Moreover, even without engaging in a plenary review of the evidence, it is clear that the punitive damages award against Barnes, which was less than the amount of compensatory damages, was not grossly excessive. *See BMW v. Gore*, ___ U.S. at ___, 116 S. Ct. at 1595.

B. Compensatory Damages

Barnes contends that the arbitrators had "no rational basis" for the amount of compensatory damages they awarded because damages were awarded for the period even after Logan was warned by his accountant "that his investment account included high-risk margin trading and that he could lose everything." Logan's arbitration claim alleged that he learned of Barnes' improprieties on August 1, 1994, whereas he admitted in his testimony that his accountant advised him of the same improprieties in early 1994. Thus, at this point, Barnes contends, Logan was no longer entitled to rely on any asserted misrepresentations by Barnes. Mrs. Logan, however, testified to a different recollection of the meeting with their accountant in early 1994 and the arbitrators could have chosen to believe her version over that of her husband's. Therefore, this is merely a dispute over the assessment of the evidence and we must defer to the arbitrator's findings of fact.

Also, as the district court noted, "the record provides no evidence that the compensatory damages were based on misrepresentation alone. As respondents point out, the panel may have assessed damages based on losses arising out of professional negligence or breaches of fiduciary duty. It is not for this court to speculate, based on the sparse

record and slim arguments, as to the panel's reasoning."[7] We agree.

> Review of arbitration awards is narrow:
>
> We review the Panel's award mindful that confirmation is required even in the face of "erroneous . . . misinterpretations of the law." . . . It is not even enough that the Panel may have failed to understand or apply the law. . . . An arbitrator's decision must be upheld unless it is "completely irrational," or it constitutes a "manifest disregard of law."

Todd Shipyards, 943 F.2d at 1060 (citations omitted). Here, it cannot be said that the amount of compensatory damages awarded is either "completely irrational" or in "manifest disregard of the law." Under the deferential standard of judicial review applicable to arbitrators' awards,

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[7] The Customer Agreement provided: "The arbitrators' award is not required to include factual findings or legal reasoning and any party's right to appeal or to seek modification of rulings by the arbitrators is strictly limited."

In accordance with that dispensation, the arbitration award contains no factual findings or conclusions of law. It consists of a "Case Summary," which amounts to a summary of the parties' contentions, "Relief Requested," "Other Issues Considered and Decided," and an "Award." It is six pages long, including a title page and a signature page.

the district court did not err in confirming the award of compensatory damages.

IV. SANCTIONS

Logan seeks attorney's fees and double costs under Fed. R. App. P. 38. His reasons are "the lack of support in the law for Barnes' various positions, the defalcations which Barnes committed against them, and the nature of their present circumstances." Two of the three reasons given have nothing to do with the merits of Barnes' appeal, but with his underlying conduct and Logan's "circumstances." These are not reasons to assess sanctions under Rule 38. On the merits, this appeal does not appear to be frivolous or wholly without merit. The Minnesota law of punitive damages was not "clarified" until the pendency of this appeal. The request for Rule 38 sanctions is denied. *See Taylor v. Sentry Life Ins. Co.*, 729 F.2d 652, 656 (9th Cir. 1984) (imposing sanctions where appeal was "wholly without merit").

The judgment of the district court is **AFFIRMED.**

APPENDIX C

APPENDIX C

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT CALIFORNIA

MILTON BARNES,	)	
	)	Nos. C-96-0957 MHP,
Petitioner,	)	C-96-0808 MHP
	)	
vs.	)	**MEMORANDUM AND**
	)	**ORDER**
MARTIN LOGAN;	)	
KOREN LOGAN,	)	May 29, 1996
Trustees for the Logan	)	
Inter Vivos Trust,	)	PATEL, District Judge
	)	
Respondents.	)	
	)	

Milton Barnes petitions this court for an order vacating an arbitration award against him. In a related case, John G. Kinnard and Company, Inc. ("Kinnard") and Scott R. Grady, Kinnard's branch manager in Phoenix, petition the court for an order vacating the same arbitration award. Now before this court are separate motions by Barnes and Kinnard to vacate the arbitration award and cross motions by Martin and Koren Logan, as trustees for the Logan Trust, to confirm the arbitration award. Because the motions in the two cases raise nearly identical issues and involve the same arbitration, the court will consider them together.

Having considered the parties' arguments and submissions, and for the reason set forth below, the court enters the following memorandum and order.

BACKGROUND

As a result of an industrial accident, Martin Logan received a settlement award in 1989 of $1.3 million and began investing that money that same year through Jeff Burrows and Milton Barnes, both of whom were with the brokerage firm of Bateman Eichler, Hill Richards Inc.

According to Barnes and Kinnard, the Logans identified their investment objective as "aggressive income" rather than "conservative income" or "conservative appreciation." The Logans maintain, to the contrary, that Mr. Logan informed Burrows that the funds needed to last him the rest of his life and that he therefore sought a conservative investment strategy.

The Logans followed Burrows and Barnes to PaineWebber in early 1993 and then moved their account to Kinnard when Barnes joined that brokerage firm's Phoenix office later that year. In late 1993 Kinnard and the Logans entered into a customer agreement that included, inter alia, choice of law and arbitration provisions.[1]

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[1] The choice of law provision in the agreement states that "[t]his agreement shall be deemed to have been made in the state of Minnesota and shall be construed, and the rights and liabilities of the parties determined, in accordance with the laws of the State of Minnesota." Decl. of Frank Lewis, Exh. D at ¶ 14.

(continued...)

At this point, the parties' account of the facts diverge remarkably. According to the Logans, Barnes promised them he would "take care of them" according to their investment goals when he took over sole control of the Logan account in 1993. Unbeknownst to them, Barnes was far from trustworthy: his professional history included five complaints, a letter of warning from the Chicago Board Options Exchange and work with seven brokerage firms in nine years. The Logans maintain that the account had a balance of $464,000 when it was opened at Kinnard and that despite sustaining losses of $195,000 over a nine month period, the account still generated roughly $123,000 in commissions for Barnes and Kinnard. During that period, the Logans report that the portfolio went from being diversified between bonds and equities to being eventually concentrated in the stock of a single speculative company. The Logans state that they were sent only one activity letter during this time and were never told of the commissions the account was generating. They add that when they filed

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[1](...continued)

The arbitration provision requires all disputes arising over the account to be submitted to binding arbitration which "shall be conducted pursuant to the Federal Arbitration Act and the laws of the State of Minnesota before a recognized organization which provides an arbitration facility in accordance with the rules obtaining of the selected organization." *Id.* at ¶ 17.

The arbitration disclosures contained in the agreement state that arbitration is final and binding on the parties and that the "arbitrators' award is not required to include factual findings or legal reasoning and any party's right to appeal or to seek modifications of rulings by the arbitrators is strictly limited." *Id.* at ¶ 16.

their claim, they were offered $330,000 in reimbursement for market losses and Barnes was asked to resign.

According to Barnes and Kinnard, the Logans were knowledgeable investors who were happy until their high risk strategy failed them. When the Logans moved the account to Kinnard they specifically reiterated their aggressive investment goals. Moreover, the account increased in value and it was not until it began to decline in 1994 that the Logans complained.

On December 9, 1994, the Logans initiated an arbitration action against Barnes, Kinnard and Grady before the National Association of Securities Dealers ("NASD"). After a four-day hearing in October of 1995 the arbitration panel determined that Barnes, Kinnard and Grady were jointly and severally liable for approximately $289,000 in compensatory damages, including interest, and awarded the Logans $500,000 in punitive damages against Kinnard and $250,000 in punitive damages against Barnes.

LEGAL STANDARD

The Federal Arbitration Act allows a district court to vacate the decision of an arbitration panel in five situations. 9 U.S.C. § 10(a)(1)-(5) (Supp. 1996). Relevant to the instant action is the ability of a court to vacate an award "[w]here the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made." 9 U.S.C. § 10(a)(4).

This subsection has been interpreted to allow a court to vacate an arbitration award where the arbitrators exceeded their authority by ruling on a matter not submitted to them or acting outside the scope of the contractual agreement,

Michigan Mutual Ins. Co. v. Unigard Security Ins. Co., 44 F.3d 826, 830 (9th Cir. 1995), or where the award evidences a manifest disregard for law. *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1060 (9th Cir. 1990).[2]

In order to determine that arbitrators did not exceed their authority, courts must ensure that an award is based on the words of the contract and the conduct of the parties. *Michigan Mutual*, 44 F.3d 826, 831 (quoting *Edward Hines Lumber Co. v. Lumber & Sawmill Workers Local No. 2588*, 764 F.2d 631, 635 (9th Cir. 1985); *see also Western Employers Ins. Co. v. Jefferies & Co.*, 958 F.2d 258, 261-62 (9th Cir.1992) (arbitrators exceeded their authority by failing to make findings of fact and conclusions of law as the contract required). However, this inquiry is an extremely limited one. "If, on its face, the award represents a plausible interpretation of the contract, judicial inquiry ceases and the award must be enforced." This remains so

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[2] Kinnard argues in its reply brief that "manifest disregard of the law" is a separate, non-statutory ground on which to vacate an arbitration award and differs from the requirement under section 10(d) that arbitrators may not exceed their powers. Section 10(d) was redesignated in 1990 as section 10(a)(4) and the court will refer to it as such. Kinnard bases this argument on a footnote in *Coast Trading Co., Inc. v. Pacific Molasses Co.*, 681 F.2d 1195, 1197 n.2 (9th Cir. 1982) and on the structure of the rationale in *Michigan Mutual*, 44 F.3d at 830, 833. Kinnard may be correct, as cases provide differing inquiries in each case, but in the end the distinction is one that does not prove helpful for Kinnard and Barnes. Both grounds appear to emanate from section 10(a)(4), see *Todd Shipyards*, 943 F.2d at 1059-60, and both contemplate an extraordinary deferential posture on the part of the district court with respect to arbitration awards.

even if the basis for the arbitrator's decision is ambiguous and notwithstanding the erroneousness of any factual findings or legal conclusions. *Sheet Metal Workers Int'l Ass'n, Local No. 359 v. Arizona Mechanical & Stainless, Inc.*, 863 F.2d 647, 653 (9th Cir. 1988) (citations omitted). In other words, a court's conviction that an arbitrator committed serious legal error is not enough to vacate an award where the construction of the contract is arguable. *Id.* (citing *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29 (1987)).

Manifest disregard of the law likewise "means something more than just an error in the law or a failure on the part of the arbitrators to understand or apply the law. It must be clear from the record that the arbitrators recognized the applicable law and then ignored it." *Michigan Mutual*, 44 F.3d at 832 (citations omitted); *see also Todd Shipyards*, 943 F.2d at 1060; *Greening v. Stratton Oakmont, Inc.*, 1996 WL 61095, *2 (N.D. Cal. 1996).

Therefore, this court reviews the arbitrators' award cognizant of the repeated admonitions by the Supreme Court and the Ninth Circuit that section 10 is to be interpreted narrowly. *See e.g., First Options of Chicago, Inc. v. Kaplan*, ___ U.S. ___, 115 S. Ct. 1920, 1923 (1995) (when the parties agree that an issue should be resolved by arbitration "the court should give considerable leeway to the arbitrator, setting aside his or her decision only in narrow circumstances"); *Todd Shipyards*, 943 F.2d at 1060.

DISCUSSION

Barnes and Kinnard move to vacate the arbitration award on the grounds that the arbitrators exceeded their authority and evinced a manifest disregard of the law by awarding punitive damages contrary to the choice of law

provision and without evidence of the parties' financial conditions. Barnes adds that the due process clause requires that punitive damage awards be reviewed. Barnes and Kinnard also argue that the arbitrators disregarded the law by awarding compensatory damages for losses sustained after the Logans learned of the alleged wrongdoing.

A. Punitive Damages

1. Scope of Arbitral Authority

First, Barnes and Kinnard argue that the arbitrators were without authority to award punitive damages because the terms of the contract required application of Minnesota law, which they assert does not allow punitive damages where the injuries are solely economic. The Logans not only dispute petitioners' characterization of Minnesota law, but respond that the arbitration provision of the contract allows for punitive damage awards by authorizing application of NASD rules.

Both parties rely on the Supreme Court's recent decision in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, ___ U.S. ___, 115 S. Ct. 1212 (1995) to support their respective positions. In *Mastrobuono*, a case arising from alleged mismanagement of a securities trading account, the Court considered whether an arbitration award of punitive damages was proper under a standard form Client Agreement that contained a New York choice-of-law provision and an arbitration provision compelling arbitration pursuant to NASD rules.[3] *Id.* at 1214-15. Under New

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[3] The client agreement at issue in *Mastrobuono* provided that it would be "governed by the laws of the State of New York" and that disputes or breaches would be (continued...)

York law the "Garrity rule" allows courts but not arbitrators to award punitive damages. *Id.* at 1217. NASD rules, on the other hand, permit arbitrators to consider punitive damages as a remedy. *Id.* at 1218. The Court noted that the agreement nowhere expressly referred to claims for punitive damage, *id.* at 1217, that the choice-of-law provision introduced an ambiguity into the agreement, which otherwise would allow punitive damage awards, and that ambiguities as to the scope of the arbitration clause should be resolved in favor of arbitration. *Id.* at 1218. Applying principles of contract construction the Court then harmonized the conflicting provisions by reading the choice-of-law provision to encompass substantive state law but to exclude state limitations on the authority of arbitrators. *Id.* at 1219. The Court concluded by upholding the arbitration award "as within the scope of the contract." *Id.*

Barnes and Kinnard argue that *Mastrobuono* mandates that any arbitration award must be consistent with the substantive state law governing the arbitration. Because Minnesota law does not limit the power of arbitrators, but merely provides substantive guidance on when punitive damages may be awarded, they maintain that the award in the instant action must comport with that law. They rely on *Gateway Technologies, Inc. v. MCI Communications Corp.*, 64 F.3d 993 (5th Cir. 1995), which vacated an arbitrator's punitive damage award as contrary to the applicable state law. *Id.* at 1001. In *Gateway*, the

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[3](...continued)
"settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc., or the Board of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange Inc." 115 S. Ct. at 1216-17 n.2.

arbitrator of a contract dispute misapplied Virginia substantive law, which only allows for punitive damages predicated on tort liability. *Id.* at 999.

Petitioners' reliance on Gateway is ill-advised in several respects. To begin with, the contract in that case did not contain a choice-of-law provision, *id.* at 998 n.9, thus the court was not concerned with whether the arbitrator acted within the scope of the agreement by awarding punitive damages, but rather whether there was legal error in doing so. The substantive law the arbitrator applied in that case was the law of Virginia, where the arbitrator heard the dispute. *Id.* at 998. This is consistent with the arbitrators' actions in the present case, where they expressly awarded punitive damages pursuant to the law of California, where they heard the dispute, and *Mastrobuono*. Lewis Decl., Exh. A at 5. Furthermore, the inquiry conducted by the Fifth Circuit was fundamentally different from the one this court must conduct. The contract at issue in *Gateway* expressly provided expanded review of the arbitration award for errors of law. *Id.* at 996. Pursuant to that contractual agreement, the court conducted de novo review of the legal issues underlying the arbitration award. *Id.* at 997.

This court's role, in contrast, is not to scrutinize the law the arbitrators applied, but to determine whether their decision was based on a plausible interpretation of the contract and therefore within their authority. *See Sheet Metal Workers*, 863 F.2d at 653. The customer agreement in the present case contained a choice-of-law provision applying Minnesota law to the construction of the agreement as well as an arbitration clause mandating arbitration pursuant to the Federal Arbitration Act and Minnesota law before an organization "in accordance with the rules obtaining of the selected organization." Lewis

Decl., Exh. D at ¶ 17. NASD rules have been interpreted to allow arbitrators to award punitive damages.[4] *Mastrobuono*, 115 S. Ct. at 1218 & n.5; NASD Notice to Members 95-85 (October 1995). Assuming without deciding that Minnesota law comports with petitioners' characterization, the customer agreement is at best ambiguous. In addition, that ambiguity could only have been exacerbated by the fact that in briefing the issue of punitive damages in their answer to the claim, Kinnard and Grady only addressed California law, not once raising the applicability of Minnesota law. Rains Decl., Exh. C at 16-17. As the Supreme Court made clear in *Mastrobuono*, petitioners "cannot overcome the common-law rule of contract interpretation that a court should construe ambiguous language against the interest of the party that drafted it. [The drafting party] drafted an ambiguous document, and they cannot now claim the benefit of the doubt." *Mastrobuono*, 115 S. Ct. at 1219 (citations omitted).

Accordingly, as the arbitrators acted according to an arguable interpretation of the customer agreement, this court will not vacate their award of punitive damages on the grounds that they exceeded their authority.

2. Manifest Disregard of the Law

Barnes and Kinnard also assert that the award of punitive damages was in manifest disregard of the law because the arbitration panel did not hear evidence of petitioners' financial condition as required under the

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[4] Regardless of whether there is a specific NASD rule authorizing arbitrators to award punitive damages, which the parties dispute, the Supreme Court's conclusions on the matter provide adequate authority.

California law which the panel applied. The arbitration award specified that punitive damages were assessed pursuant to Section 3294 of the California Civil Code. Lewis Decl., Exh. A at 5. Petitioners argue that *Adams v. Murakami*, 54 Cal. 3d 105 (1991) holds that a trier of fact may not assess punitive damages against a defendant unless the record contains evidence of the defendant's financial condition.

Petitioners' mischaracterize *Adams*, which does not bar a trier of fact from awarding punitive damages without financial evidence. Rather, *Adams* finds that a "reviewing court cannot make a fully informed determination of whether an award for punitive damages is excessive unless the record contains evidence of the defendant's financial condition." *Id.* at 110. Based on *Adams* a reviewing court may well reverse a punitive damage award where no evidence of financial condition was introduced. But that is not the posture of the instant action. There is no claim that the punitive damages awarded were excessive, only that they were awarded with manifest disregard for the law. However, the panel specifically requested briefing on the issue of punitive damages and the parties each addressed the applicability of *Adams*. Lewis Decl., Exhs. E & F. Moreover, the Logans argued in their brief that even if *Adams* controlled, there was already sufficient evidence of respondents' financial condition in the record.

Nothing in the record before this court suggests that the arbitration panel recognized that *Adams* represented the applicable law and then chose to ignore it. The very fact that the panel requested briefing on punitive damages suggests otherwise -- that they considered the law presented to them. The arbitrators had before them all the potentially applicable law as well as some evidence of net worth. There is nothing to indicate that once armed with this

information, the arbitrators then ignored it. At the most, they got it wrong, and legal error alone would not merit overturning the award.[5] Accordingly, the punitive damages awarded against petitioners do not evidence a manifest disegard for the law.

3. Due Process

Finally, Barnes alone argues that the punitive damage award against him, made without evidence of his net worth and without judicial review, violates Due Process. This court agrees with the district court's assessment in *Greening* that that argument was "flatly rejected" by the Ninth Circuit in *Todd Shipyards*. *Greening*, 1996 WL 61095, *5. There the court noted that the party seeking to vacate the arbitration award had entered into a binding arbitration voluntarily and that it "cannot agree to arbitrate 'all disputes' and then assert that an award made pursuant to that agreement, unless faulty for some reason, denies due process because it is not sufficiently reliable." *Todd Shipyards*, 943 F.2d at 1063-64. Barnes entered into the arbitration agreement fully aware of the nature of the proceedings involved and the limited judicial review it

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[5] With respect to legal error, the relative lack of legal expertise on the part of the arbitrators is something petitioners should have anticipated. Brokerage firms favored the binding arbitration policy knowing full well that the arbitration panels would consist primarily of industry representatives rather than lawyers.

afforded;[6] pursuant to that review, this court has not found the arbitration award faulty nor violative of Due Process.

B. Compensatory Damages

Barnes and Kinnard contend that the arbitrators' award of compensatory damages was in manifest disregard of the law because the award compensated for losses that occurred after the Logans learned of any improprieties in the management of their account. Relying on cases brought under Rule 10b-5 of the Securities Exchange Act of 1934 which hold that it is error to award damages for losses occurring after investors were influenced by misrepresentations, see *Nye v. Blyth Eastman Dillon & Co., Inc.*, 588 F.2d 1189, 1198 (8th Cir. 1978), petitioners point to admissions by Martin Logan that his accountant warned him in early 1994 of mismanagement and alerted him that he could lose everything. Because the account was still profitable at this time, petitioners claim the compensatory damages are in manifest disregard of the law.

Even assuming *Nye* to be the applicable law, the claim brought by the Logans before NASD was based on more than fraud, Lewis Decl., Exh. B, and the record provides no evidence that the compensatory damages were based on

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[6] The arbitration disclosures in the customer agreement state:

Arbitration is final and binding on the parties. The parties are waiving their right to seek remedies in court, including the right to jury trial. . . . The arbitrators' award is not required to include factual findings or legal reasoning and any party's right to appeal or to seek modification of rulings by the arbitrators is strictly limited. Lewis Decl., Exh. D at ¶ 16.

misrepresentation alone. As respondents point out, the panel may have assessed damages based on losses arising out of professional negligence or breaches of fiduciary duty. It is not for this court to speculate, based on a skeletal record and slim arguments,[7] as to the panel's reasoning. Rather, it is enough that there is no indication that the arbitrators recognized the law petitioners cite as applicable and then chose to ignore it.

Accordingly, the arbitration award of compensatory damages was not in manifest disregard of the law and shall not be vacated.

For the foregoing reasons, IT IS HEREBY ORDERED that petitioners' motion to vacate the arbitration award is DENIED; and respondent's motion to confirm the arbitration award is GRANTED.

IT IS SO ORDERED.

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[7] The scant record of the proceedings is in accord with the customer agreement, which specifies that an arbitration award need not include factual findings or legal reasoning. Lewis Decl., Exh. D at ¶ 16.

APPENDIX D

APPENDIX D

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

In the matter of the Arbitration Between

Name of Claimants

Martin Logan and Koren Logan, Trustees
for the Logan Inter Vivos Trust

NASD Arbitration
No. 94-05214

Name of Respondents

John G. Kinnard & Company, Inc.
Milton Barnes
Scott Grady

REPRESENTATION

For Claimants: David S. Markun, Esq., Zelle & Larson, San Francisco, California

For Respondents John G. Kinnard & Company, Inc. and Scott Grady: F. Chet Taylor, Esq., John G. Kinnard & Company, Inc., Minneapolis, Minnesota

For Respondent Milton Barnes: Frank Lewis, Esq., Begam Lewis Marks & Wolfe, Phoenix, Arizona

CASE INFORMATION

Statement of Claim filed: December 9, 1994

Claimants' Submission Agreement signed: January 5, 1995

Statement of Answer, Cross-Claim, and Third-Party Claim of Respondents John G. Kinnard & Company, Inc. and Scott Grady filed: March 16, 1995

Statement of Answer filed by Respondent Milton Barnes: March 1, 1995

Respondents' Submission Agreements signed as follows:

John G. Kinnard & Company, Inc.:
March 16, 1995 and June 12, 1995
Scott Grady: June 14, 1995
Milton Barnes: February 28, 1995

HEARING INFORMATION

Pre-Hearing Conference Date(s)/Session(s):
September 14, 1995 (one session)
September 18, 1995 (one session)

Hearing Date(s)/Session(s):
October 17, 1995 (two sessions)
October 18, 1995 (two sessions)
October 19, 1995 (two sessions)
October 20, 1995 (two sessions)

Hearing Location: San Francisco, California

CASE SUMMARY

Claimants Martin Logan and Koren Logan, trustees for the Logan Revocable Inter Vivos Trust, alleged that they were not knowledgeable in the area of securities investments and that they advised Respondents that they had little knowledge or experience regarding investments and that they needed the assistance of a good and conservative investment counselor to invest their assets in a prudent and conservative manner. Claimants further alleged the following causes of action with respect to their investments in various securities: 1) Fraud and Deceit based on Omission of Material Facts; 2) Professional Negligence; 3) The "Know Your Securities" Rule; 4) Breach of Fiduciary Duty; 5) Intentional Misrepresentation; 6) Negligent Misrepresentation; 7) John G. Kinnard & Company's Failure to Supervise; 8) Agency; and 9) Dependent Adult/Fiduciary Abuse.

Respondents John G. Kinnard & Company, Inc. (Kinnard) and Scott Grady denied Claimants' allegations of wrongdoing. Kinnard and Grady alleged that the above-captioned dispute represents a classic example of investors who fully understood the risks involved in their aggressive investment strategy, and were content to assume those risks as long as their account was profitable; then, the tables turned, and the same risks that led to significant profits caused the Logans to sustain significant losses; when that happened, the Logans were magically transformed into conservative investors, looking only for safe, secure investments; and that the Logans' conduct both before coming to Kinnard and while at Kinnard, and the documentary evidence in this matter contradict the Logans' current claims of naivete. Kinnard and Grady further alleged that: 1) The Logans cannot satisfy any of the elements of a churning claim; 2) The Logans cannot state

a claim for unsuitability; 3) The Logans authorized every trade in their account; 4) The Logans' common law claims against Kinnard and Grady must be denied; 5) The Logans suffered no losses that can be attributed to Kinnard or Grady; 6) The Logans' "control person" theory must fail because Kinnard and Grady acted in good faith at all times; and 7) The Logans are not entitled to punitive damages from Kinnard or Grady.

In their Cross-Claim, Kinnard and Grady alleged that although they believe that the Logans' account was handled in accordance with the Logans' instructions, if the arbitration panel determines otherwise, then any misconduct was solely on the part of Barnes; and that under those circumstances, Kinnard and Grady would be entitled to complete indemnification from Barnes for any and all damages assessed against Kinnard or Grady.

Respondent Milton Barnes denied any liability to Claimants and denied Claimants' allegations of wrongdoing. Respondent Barnes alleged that: 1) all of the trading done in Claimants' account at Kinnard was done with the knowledge and consent of the Claimants; 2) the trading was done in an effort to reach the stated goals of Claimants; 3) Claimants were advised of and consented to the speculative and aggressive nature of the trading in their account; (4) Claimants were advised that the level of withdrawals they sought to and actually made from the account, could not be covered by conservative investing; and 5) Claimants were aware, as a result of conversations with Barnes, confirmations and monthly statements from Kinnard, and acknowledgements signed by Claimants, that their account was active, very volatile and was of necessity engaging in aggressive trading. Respondent Barnes further alleged that it is unfortunate that Claimants' account had market losses and alleged that in view of the background of

the agreed to aggressive trading in the account and the fact that Claimants understood and approved the trading strategies in the subject account, Barnes is not, and should not be held responsible for any of the losses.

RELIEF REQUESTED

Claimants requested:

1. Compensatory damages in an amount of not less than $750,000.00 and according to proof at the time of hearing;

2. Loss of future profits to be determined at hearing;

3. Pre-judgment and post-judgment interest at the highest legal rate;

4. Punitive damages in the amount of $3,000,000.00;

5. All costs of suit including attorneys an consulting fees under Welfare and Institutions Code Section 15600, et seq.;

6. Treble damages pursuant to Civil Code Section 3345; and

7. Such further relief as the arbitration panel deems just and proper.

Respondents Kinnard and Grady requested that the Logans' Statement of Claim be dismissed in its entirety, with the Logans recovering nothing from Kinnard and Grady.

Respondent Barnes requested dismissal of Claimants' claims.

OTHER ISSUES CONSIDERED AND DECIDED

On or about July 10, 1995, the panel of arbitrators was advised of Third-Party Respondent Jeffrey Burrows' bankruptcy filing and that the above-captioned matter was stayed with respect to Jeffrey Burrows.

On or about August 31, 1995, the panel of arbitrators was advised that John G. Kinnard & Company, Inc. and Scott Grady dismissed their third-party claims against Kemper Securities, Inc. and Jeffrey Burrows voluntarily and without prejudice; and that John G. Kinnard & Company, Inc. and Scott Grady dismissed their third-party clams against PaineWebber Incorporated with prejudice.

The parties have agreed that the Award in this matter may be executed in either counterpart copies or that a handwritten, signed Award may be entered. In either case, the parties have agreed to receive conformed copies of the Award while the originals remain on file with the National Association of Securities Dealers, Inc. (NASD).

AWARD

After considering the pleadings, the testimony, the evidence presented at the hearing and post-hearing submissions, the undersigned arbitrators have decided in full and final resolution of the issues submitted for determination as follows:

1. Respondents John G. Kinnard & Company, Inc.'s and Scott Grady's Motion to Exclude Post-Hearing Evidence is granted.

2. Respondents John G. Kinnard & Company, Inc., Scott Grady and Milton Barnes are jointly and severally liable for and shall pay to Claimants the sum of $261,561.00 in compensatory damages.

3. Respondents John G. Kinnard & Company, Inc., Scott Grady and Milton Barnes are jointly and severally liable for and shall pay to Claimants the sum of $27,463.00 in interest.

4. Respondent John G. Kinnard & Company, Inc. is solely liable for and shall pay to Claimants the sum of $500,000.00 in punitive damages pursuant to Section 3294 of the California Civil Code and pursuant to Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995).

5. Respondent Milton Barnes is solely liable for and shall pay to Claimants the sum of $250,000.00 in punitive damages pursuant to Section 3294 of the California Civil Code and pursuant to Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995).

6. All claims with respect to the Cross-Claim of John G. Kinnard & Company, Inc. and Scott Grady against Milton Barnes are dismissed.

7. The parties shall each bear their respective costs including attorney's fees.

FORUM FEES

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the following forum fees are assessed: The NASD shall refund the $750.00 hearing session deposit previously deposited by the Claimants and shall retain the $1,250.00 hearing session deposit previously deposited by John G. Kinnard & Company, Inc. Forum fees are assessed against Respondents John G. Kinnard & Company, Inc., Scott Grady and Milton Barnes, jointly and severally, in the amount of $7,350.00, calculated as follows: Two pre-hearing sessions times $300.00/session plus eight hearing sessions times $1,000.00/session minus the $1,250.00 retained by the NASD.

Fees are payable to the National Association of Securities Dealers, Inc.

ARBITRATORS

Name	Public/Industry
Walter P. Hitchcock, Esq.	Public Arbitrator
Amy Seltzer, Ph.D.	Public Arbitrator
Thomas W. Borden	Industry Arbitrator

Concurring Arbitrators' Signatures

/s/

Walter P. Hitchcock, Esq.

Amy Seltzer, Ph.D.

Thomas W. Borden

Date of Decision: 1/4/96

Date Served: 01/30/96

FORUM FEES

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Walter P. Hitchcock, Esq.	Public Arbitrator
Amy Seltzer, Ph.D.	Public Arbitrator
Thomas W. Borden	Industry Arbitrator

Concurring Arbitrators' Signatures

Walter P. Hitchcock, Esq.

/s/

Amy Seltzer, Ph.D.

Thomas W. Borden

Date of Decision: 1/25/96
Date Served: 01/30/96

FORUM FEES

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the following forum fees are assessed: The NASD shall refund the $750.00 hearing session deposit previously deposited by the Claimants and shall retain the $1,250.00 hearing session deposit previously deposited by John G. Kinnard & Company, Inc. Forum fees are assessed against Respondents John G. Kinnard & Company, Inc., Scott Grady and Milton Barnes, jointly and severally, in the amount of $7,350.00, calculated as follows: Two pre-hearing sessions times $300.00/session plus eight hearing sessions times $1,000.00/session minus the $1,250.00 retained by the NASD.

Fees are payable to the National Association of Securities Dealers, Inc.

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Walter P. Hitchcock, Esq.	Public Arbitrator
Amy Seltzer, Ph.D.	Public Arbitrator
Thomas W. Borden	Industry Arbitrator

Concurring Arbitrator's Signatures

_____

Walter P. Hitchcock, Esq.

_____

Amy Seltzer, Ph.D.

/s/

Thomas W. Borden

Date of Decision: _____

Date Served: 01/30/96